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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 19

BRADLEY W. PALMER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 59

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

BRADLEY W. PALMER

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE COMMISSIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 155–170) is reported in 32 B. T. A. 550. The opinion of the Circuit Court of Appeals (R. 187–197) is reported in 88 F. (2d) 559.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered February 12, 1937. (R. 197.) The petition for a writ of certiorari in No. 19 was filed March 31, 1937, and granted May 17, 1937. (R. 197, 198.) The petition in No. 59 was filed May 12, 1937, and granted June 1, 1937. (R. 198.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

No. 19

Where a corporation issues to its stockholders rights to acquire from it shares of stock which it owns in other corporations, at a price substantially less than the fair market value of such shares, and the rights are exercised, does the transaction constitute a taxable dividend to the stockholders?

No. 59

The court below held that the transaction constituted a taxable dividend to the stockholders, and the question presented in the Commissioner's petition is: As of what date should the stock or rights be valued for the purpose of determining the amount of the dividend?

STATUTE INVOLVED

The Revenue Act of 1928, c. 852, 45 Stat. 791, provides in part as follows:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.
>
> * * * * *
>
> SEC. 115. DISTRIBUTIONS BY CORPORATIONS.
>
> (a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.
>
> (b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in

value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

* * * * *

STATEMENT

The facts are set forth in a stipulation (R. 64–155) agreed upon between the parties and adopted by the Board as its findings (R. 170). The material facts may be summarized as follows:

On January 1, 1929, the taxpayer was the owner of 6,396 shares of common stock of the American Superpower Corporation (hereinafter referred to as Superpower), which were acquired on and after September 22, 1927. On June 10, 1929, he acquired four additional shares, making a total of 6,400 shares of Superpower stock held by him on June 10, 1929. On or about June 11, 1929, the common stock of Superpower was split up five for one, and taxpayer received 32,000 shares of new common stock in exchange for the 6,400 shares originally held by him. (R. 65.)

Superpower, a Delaware corporation, was organized in 1923, and at the beginning of 1929 its assets consisted principally of preferred and common stocks of domestic corporations. Among its assets were 800,000 shares of common stock of Public Service Corporation of New Jersey, and 53,000

shares of common stock of the United Gas Improvement Company. (R. 74.) On January 7, 1929, the United Corporation (hereinafter referred to as United) was organized as a holding corporation in order to pool the interests of certain minority stockholders of the Public Service Corporation of New Jersey, the United Gas Improvement Company, and Mohawk & Hudson Power Corporation. Superpower was a participant therein, and in connection therewith disposed of its holdings of common stock of the Public Service Corporation of New Jersey, and the United Gas Improvement Company, and received in exchange certain securities of United, including 2,210,853 shares of its common stock. (R. 65, 75–77.)

On January 23, 1929, the board of directors of Superpower approved a plan for distributing a portion of Superpower's holdings of United stock to its stockholders. By resolutions then adopted, all of its stockholders of record on January 26, 1929, were given the right to acquire from Superpower, at $25 per share, one-half share of United stock for each share of Superpower stock. The same resolutions approved forms of certificates to evidence such rights and authorized arrangements for the preparation and mailing of such certificates and for the transfer and delivery to the stockholders of the requisite number of shares of United stock, upon their surrendering the certificates and making the payments as therein provided. The board also approved a proposed form of public announcement

and, under date of January 24, 1929, the stockholders were notified of the action taken by the board, such notice being received by the taxpayer on January 25, 1929. In this announcement, the stockholders were notified that certificates evidencing the rights were to be mailed on or about February 1, 1929. (R. 13–17, 66.)

On January 31, 1929, certificates dated February 1, 1929, were mailed by Superpower to all of its stockholders of record on January 26, 1929. The taxpayer on February 1, 1929, received his certificates which recited that he, as the holder of 6,396 shares of Superpower stock, was entitled to acquire from the corporation 3,198 shares of United stock at a price of $25 per share. On February 15, 1929, the taxpayer paid to Superpower the sum of $79,950, surrendered the certificates and received 3,198 shares of United stock. (R. 66–67.)

On January 26, 1929, the number of shares of common stock of Superpower outstanding was 1,642,944; and the number of rights issued was 1,642,944. Starting on January 25, 1929, the above mentioned rights were dealt in on the New York Curb Exchange and ranged from a low of 11⅝ on January 25th to a high of 21 on January 30th, and to a low of 12⅜ on February 15th. On January 26th, the date named for determining the stockholders of record who were entitled to receive the rights, they sold on the market for a high of 12⅞

and a low of 12⅛. And on February 1, 1929, the date the taxpayer received his certificates evidencing the rights, they sold for a high of 18 and a low of 16¼. (R. 67.)

On January 29, 30 and 31, 1929, Superpower sold substantial blocks of United common stock at prices ranging from $56.96 to $63.46. (R. 83–84.)

The Commissioner of Internal Revenue determined that the rights so issued by Superpower represented the distribution of taxable dividends, and determined the amount thereof to be the fair market value of such rights on January 26, 1929, namely, $12.50 per right, and included in respondent's gross income, as dividends, the amount of $79,950 on account thereof. (R. 68.)

On May 1, 1929, similar action was taken by the directors of Superpower with respect of further holdings of United common stock, the stockholders of record on May 8, 1929, being given the right to acquire United stock at $30 per share and at the rate of one share of United for each four shares of Superpower stock. On May 2, 1929, the stockholders were notified of the action of the directors, such notice being received by the taxpayer on May 3, 1929. In this announcement, the stockholders were advised that certificates evidencing the rights were to be mailed on or about May 8, 1929. (R. 23–24, 68.)

On May 13, 1929, the taxpayer received from Superpower a communication mailed May 12, 1929,

and dated May 8, 1929, enclosing a certificate which recited that he, as the holder of 6,396 shares of Superpower common stock was entitled to acquire from the corporation 1,599 shares of United stock at a price of $30 per share. On May 24, 1929, the taxpayer paid to Superpower the sum of $47,970 in cash, surrendered the certificate and received 1,599 shares of United stock. (R. 68–69.)

On May 8, 1929, the number of shares of common stock of Superpower outstanding was 1,643,216, and the number of rights issued was 1,643,216. Starting on May 2, 1929, the rights were dealt in on the New York Curb Exchange and ranged from a low of 6⅛ on May 2nd to a high of 11⅜ on May 11th. On May 8, 1929, the date named for determining the stockholders of record who were entitled to receive the rights, they sold on the market for a high of 8⅞ and a low of 8⅜. On May 13th, the date the taxpayer received his certificate evidencing the rights, they sold for a high of 10⅝ and a low of 9¼. (R. 69–70.) The Commissioner of Internal Revenue determined that the rights so issued by Superpower represented the distribution of taxable dividends and determined the amount thereof to be the fair market value of such rights on May 8, 1929, namely, $8.625 per right, and included in taxpayer's gross income as dividends the amount of $55,165.50 on account thereof. (R. 70.)

Prior to June 18, 1929, Superpower acquired certain shares of common stock of the Common-

wealth and Southern Corporation (hereinafter referred to as Commonwealth), a corporation organized under the laws of Delaware on May 23, 1929. On June 5, 1929, the board of directors of Superpower adopted certain resolutions, pursuant to which its common stockholders of record, on June 18, 1929, were given the right to purchase from the corporation one share of Commonwealth stock for each 10 shares of Superpower common stock. On June 5, 1929, the stockholders of Superpower were notified of the action of the directors, such notice being received by the taxpayer on or about June 6, 1929. In this announcement, the stockholders were advised that certificates evidencing such rights were to be mailed on or about June 22, 1929. (R. 30–31, 70–71.) On June 23, 1929, taxpayer received a letter from Superpower, dated and mailed June 22, 1929, enclosing a certificate which recited that he, as a holder of 32,000 shares of Superpower stock, was entitled to acquire from the corporation 3,200 shares of Commonwealth stock at a price of $15 per share. On July 2, 1929, the taxpayer paid to Superpower the sum of $48,000 in cash, surrendered the certificate, and received from the corporation 3,200 shares of Commonwealth stock. On June 18, 1929, the number of shares of common stock of Superpower outstanding was 8,242,310, and the number of rights issued was 8,242,310. (R. 71–72.)

Starting on June 6, 1929, such rights were dealt in on the New York Curb Exchange and ranged from a low of 11/16 on June 18th to a high of 1-15/16 on June 29th. On June 18, 1929, the date named for determining the stockholders of record who were entitled to receive the rights, they sold on the market for a high of ⅞ and a low of 11/16; and on June 24, 1929 (June 23, 1929, being a Sunday), they sold for a high of ⅞ and a low of ¾. (R. 72.)

The Commissioner of Internal Revenue determined that the rights so issued by Superpower represented a distribution of taxable dividends, and determined the amount thereof to be the fair market value of such rights on June 18, 1929, namely, $0.78125 per right, and included in taxpayer's gross income as a dividend the sum of $25,000 on account thereof. (R. 73.)

The Board of Tax Appeals held that the above transactions, whereby Superpower granted to its stockholders rights to purchase United and Commonwealth stock, did not represent distributions of taxable dividends and disallowed the deficiency based thereon. (R. 156–170, 174.) Upon appeal, the court below reversed the Board, holding that the transactions did represent the distribution of taxable dividends. The court further held that the amount of the dividend should be determined by valuing the stock as of the dates the rights were exercised. (R. 187–193.)

SPECIFICATION OF ERRORS TO BE URGED IN NO. 59 ON BEHALF OF THE COMMISSIONER

The Circuit Court of Appeals erred:

1. In holding that for the purpose of determining the amount of the dividend the stock or rights should be valued as of the dates the rights were exercised.

2. In failing to hold that for the purpose of determining the amount of the dividend the stock or rights should be valued as of the date the rights were received by the taxpayer.

3. In the alternative, in failing to hold that, for the purpose of determining the amount of the dividend, the stock or rights should be valued as of the record dates or the dates when the rights were receivable by the taxpayer.

SUMMARY OF ARGUMENT

1. It is well settled that where a corporation issues to its stockholders rights to subscribe to its own stock of the same class as that held by the stockholders, the receipt of such rights does not constitute a taxable dividend. But there is a clear distinction between rights issued to a stockholder entitling him to acquire like stock in the issuing corporation and rights entitling him to acquire *assets* of the corporation, which assets consist of stock in another corporation. In the former case, the corporation parts with nothing, while in the latter case the corporation parts with a portion of its assets.

The law on the subject of dividends has been considered many times by this Court, and the rule which may be drawn from the various cases is that any distribution to stockholders of a portion of the assets of a corporation is a dividend, whether such assets consist of cash, stock of another corporation, or other property. By the same token the distribution to a stockholder of a valuable right to acquire such property at a price substantially less than its fair market value is likewise a dividend. If the distribution to a stockholder of a share of stock in another corporation, worth $50, is a $50 dividend, the distribution of a right permitting the stockholder to acquire the same share of stock upon payment of $25 is a $25 dividend to the stockholder. That precisely is the present case. The fact that the corporate resolutions did not refer to the distribution of the rights as dividends is immaterial.

The instant case is ruled by *Peabody* v. *Eisner,* 247 U. S. 347; *Ramapo, Inc.* v. *Commissioner,* 84 F. (2d) 986 (C. C. A. 2d); and *Metcalf's Estate* v. *Commissioner,* 32 F. (2d) 192 (C. C. A. 2d). It is distinguishable from *Helvering* v. *Bartlett,* 71 F. (2d) 598 (C. C. A. 4th); *Commissioner* v. *Cummings,* 77 F. (2d) 670 (C. C. A. 5th); *Taplin* v. *Commissioner,* 41 F. (2d) 454 (C. C. A. 6th); and *Commissioner* v. *Van Vorst,* 59 F. (2d) 677 (C. C. A. 9th).

2. The taxpayer contends that the Board made a finding that the fair market value of United stock in January, 1929, was $25 per share. It is

our position that the statement in the body of the opinion of the Board which the taxpayer relies upon as being a finding is merely an argument used by the Board in support of its conclusion. Moreover, if it be deemed a finding of fact it is not supported by any substantial evidence.

3. The Commissioner, in asserting the deficiency, determined the amount of the dividend by valuing the rights as of the dates named in the corporate resolutions for determining the stockholders of record entitled to receive the rights. The court below held that the amount of the dividends should be determined by valuing the United stock as of the dates the rights were exercised. It is our position that the rights should be valued as of the dates they were received by the taxpayer, since at that time the rights or shares of stock became unqualifiedly subject to his demand.

ARGUMENT

I

THE DISTRIBUTION OF THE RIGHTS TO PURCHASE UNITED AND COMMONWEALTH STOCK CONSTITUTED A DIVIDEND WITHIN THE MEANING OF SECTION 115 OF THE REVENUE ACT OF 1928

Section 115 (a) of the Revenue Act of 1928 defines a dividend as "any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913." The question here presented is whether Superpower dis-

tributed "other property" to its stockholders pursuant to the resolutions of January 23, May 1, and June 5, 1929.[1]

The facts with respect to the three issues of rights are essentially the same. The discussion here will be confined largely to those issued in January.

In January, 1929, Superpower was the owner of 2,210,853 shares of stock of the United Corporation, and in order to effect a distribution of a portion of such stock to its stockholders, its board of directors adopted certain resolutions, pursuant

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[1] The question of the amount of accumulated earnings or profits available for dividends by Superpower is not here presented or contested. Neither the Board, which held for other reasons that there was no dividend (R. 163 ff.), nor the court below, which reversed the Board and remanded the case for further proceedings not inconsistent with its opinion (R. 197), passed upon the question. And the question is not raised by taxpayer's specification of errors. (Brief for Bradley W. Palmer, p. 13.)

In arriving at the deficiency here involved the Commissioner determined that when the distributions were made Superpower had earnings and profits accumulated after February 28, 1913, equal to or in excess of the respective amounts of such distributions as determined by him. (R. 85.)

It may be noted that in the companion case of *Oscar F. Mayer* v. *Guy T. Helvering*, No. 22, present term, which presents the same general questions as the instant case, it is expressly stipulated that taxpayer does not question the Commissioner's determination that Superpower had earnings and profits accumulated after February 28, 1913, equal to or in excess of the fair market value of the rights received by Superpower's stockholders. (See the record in the *Mayer* case at p. 15; cf. the record here at pp. 85, 87–90.)

to which its stockholders were given the right to acquire United stock at a price of $25 per share, and at the rate of one share of United for each two shares of Superpower stock. On January 26th, the date named for determining the stockholders of record who were entitled to the rights, the fair market value of United stock was approximately $50 per share.[2] (R. 67), and on January 31st it was approximately $60 per share (R. 84). To evidence the rights in tangible form, as well as to give them a readily marketable character, transferable certificates of the rights granted by the resolutions were distributed to the stockholders of Superpower. Taxpayer received his certificate on February 1st. (R. 66.) On or about February 15, 1929, all of such certificates were surrendered to the corporation, together with cash payments aggregating $20,536,800, and the stockholders received 821,772 shares of United stock worth between $41,000,000 and $50,000,000. We submit that in substance and

[2] The figure of approximately $50 per share as the fair market value of United stock on January 26th is derived from the New York Curb Exchange quotations on that date for the rights to buy United stock from Superpower. On January 26th the rights sold from a high of $12⅞ to a low of $12⅛. Thus the two rights necessary for the acquisition of one share of United stock from Superpower at $25 per share could be bought for approximately $25. Of course, $25, the fair market value of two rights, approximates the difference between the fair market value of United stock and $25, the warrant price for United stock. Thus the fair market value of United stock on January 26th was approximately $50 per share.

legal effect Superpower had distributed to its stockholders a taxable dividend to the extent of the fair market value of the rights.

The subject of dividends has been considered many times by this Court. In *Towne* v. *Eisner,* 245 U. S. 418, it was held that a stock dividend in common stock paid to holders of common stock does not constitute a taxable dividend to the recipients under the Revenue Act of 1913. *Eisner* v. *Macomber,* 252 U. S. 189, decided that such a dividend did not constitute income to the stockholders within the meaning of the Sixteenth Amendment. Accordingly, in *Miles* v. *Safe Deposit Co.,* 259 U. S. 247, it was held that when a corporation issues to its stockholders rights to acquire stock in the issuing corporation of the same class as that held by the stockholders, the receipt of such rights by the stockholders is "essentially analogous to a stock dividend" (p. 252) and not taxable.

Very shortly after the decision in the *Towne* case, the Court decided *Peabody* v. *Eisner,* 247 U. S. 347. In that case the Union Pacific Railroad Company declared a dividend, partly in cash and partly in stock of the Baltimore & Ohio Railroad Company. Tax was exacted against this dividend and it was contended that the *Towne* case controlled. In rejecting this contention, the Court said in part (p. 349–350):

> It hardly is necessary to say that this case is not ruled by our decision in *Towne* v. *Eisner,* since the dividend of Baltimore &

> Ohio shares was not a stock dividend but a distribution *in specie* of a portion of the assets of the Union Pacific, and is to be governed for all present purposes by the same rule applicable to the distribution of a like value in money. * * *

The doctrine of the *Peabody* case was reaffirmed in *United States* v. *Phellis,* 257 U. S. 156; *Rockefeller* v. *United States,* 257 U. S. 176, and *Marr* v. *United States,* 268 U. S. 536.

Thus there is a clear distinction in the cases between a distribution of a corporation's own stock to stockholders of the same class as the stock distributed, and the distribution by a corporation of a portion of its assets consisting of stock owned in another corporation. In the former case, the corporation parts with nothing (*Towne* v. *Eisner, supra,* p. 426) while in the latter case the corporation parts with a portion of its assets. So, too, there is the same distinction between a distribution by a corporation to its stockholders of rights to acquire from the corporation its stock, of the same class as that held by the stockholders, and the distribution by a corporation to its stockholders of rights to acquire from the corporation a portion of its assets, consisting of stock owned in another corporation, at a price substantially less than its fair market value. Under the principle of *Peabody* v. *Eisner, supra,* many times reaffirmed by this Court, there can be little question that an outright distribution of United stock by Superpower to its stock-

holders in the latter part of January would have constituted a dividend to them of $50 on each share of United distributed. By the same token, if the distribution to a stockholder of a share of stock of another corporation worth $50, is a $50 dividend, then the distribution of a right permitting the stockholder to acquire the same share of stock upon payment of $25 is a $25 dividend. That precisely is the present case.

Before issuance of the rights, Superpower held certain assets consisting of shares of United stock worth $50 per share. By issuing the rights, Superpower, in effect, carved out marketable interests in the United shares, consisting of irrevocable options in its stockholders to acquire the United shares from Superpower at $25 per share. These interests in the United shares Superpower disposed of to its stockholders by distribution of the certificates representing the interests. Thus Superpower parted with, and the stockholders received, an undoubtedly valuable portion of its assets.

Insofar as *Helvering* v. *San Joaquin Co.*, 297 U. S. 496, relied on by the taxpayer at page 32 of his brief, tends to support the proposition that the taxpayer did not acquire the shares of United until exercise of the rights granted, we need not quarrel with it. It is our contention that the taxpayer, irrespective of the exercise of rights and acquisition of the shares of United, received valuable interests in the United shares upon distribution of the rights. But even if the rights distrib-

uted did not constitute interests in the United shares held by Superpower,[3] nevertheless there was a dividend to the stockholders. Prior to the issuance of the rights, Superpower, as owner of the United shares, had the right to dispose of those shares and realize their fair market value. Cf. *Henneford* v. *Silas Mason Co.*, 300 U. S. 577, 582. By issuing the rights, Superpower for a definite period of time relinquished to its stockholders its right to realize so much of the fair market value of the United stock held as exceeded $25 per share. Cf. *Helvering* v. *Salvage,* 297 U. S. 106; *Wilson* v. *Bowers,* 57 F. (2d) 682 (C. C. A. 2d). The right so relinquished by Superpower and received by its stockholders was a property right of substantial value (R. 67). See *Helvering* v. *San Joaquin Co., supra,* p. 498, that "The option itself was property, and doubtless was valuable." So the stockholders of Superpower received a dividend of a portion of Superpower's assets, consisting of the transfer-

[3] Although there is no holding on the point, it is stated in *Helvering* v. *San Joaquin Co., supra,* p. 498, that "the weight of authority is to the contrary" of the proposition that an option to purchase real estate constitutes an interest in the real estate in the nature of a covenant real. The situation here involved is quite remote from the technical considerations of real property law, and we do not believe the statement of the Court in the *San Joaquin* case to be applicable here. Moreover, there is here the fact, not present in the *San Joaquin* case, that the shares subject to the rights distributed were put out of the control of Superpower and delivered to the transfer agents of United and Commonwealth to meet the exercise of the rights. (R. 66, 68, 71.)

able right to realize the fair market value of the United shares in excess of $25 per share.

That the cost to Superpower for the United shares was less than $25, the price to stockholders under the rights issued, is immaterial. The fact that Superpower for the purpose of its income tax liability realized a profit on disposition of the United shares to its stockholders at $25 per share, does not negative the paying of a dividend upon distribution of the rights, but merely indicates that the dividend paid was not as large as it might have been. Superpower might have distributed rights to buy United shares at the cost of the shares to Superpower, in which case there would have been no taxable profit to Superpower, and presumably a larger dividend to the stockholders. But so far as the present question is concerned, the hypothetical transaction, and the transactions here involved, would be in substance the same.

Nor is the fact that the corporate resolutions did not specifically refer to the distribution of the rights as a dividend controlling. *Chattanooga Sav. Bank* v. *Brewer,* 17 F. (2d) 79 (C. C. A. 6th), certiorari denied, 274 U. S. 751; *Spencer* v. *Lowe,* 198 Fed. 961 (C. C. A. 8th). The courts have uniformly held that the substance and not the form is what controls (*Eisner* v. *Macomber, supra*) and have never hesitated to hold that what purported to be a sale was actually a distribution of corporate assets. *Continental Co.* v. *United States,* 259 U. S.

156. This case involved rights similar to those under consideration here and this Court held that the transaction constituted a distribution of surplus even though it was denominated a sale. The Court said in part (p. 176):

> They all, under the plan, will receive the benefit of the difference between the real value of the privilege of disposing of their distributive certificates of interest in stock in the new Coal Company, and the payment of $2.00 or such other sum as may be fixed, per share held by them of the Reading Company stock. Such difference has already been the subject of sale and quotation on the market in New York and has varied from $11 to $20. * * * The disparity shows that while the transfer of certificates of interest in the new Coal Company stock is denominated a sale, it is only a *distribution of the surplus or assets of the Reading Company to its stockholders* * * *. [Italics supplied.]

See also *Venner* v. *Southern Pac. Co.*, 279 Fed. 832, 843 (C. C. A. 2nd), certiorari denied, 258 U. S. 628.

A case similar in all respects to the instant one is *Metcalf's Estate* v. *Commissioner*, 32 F. (2d) 192 (C. C. A. 2d). In that case the Southern Pacific Company organized Pacific Oil Company and subscribed for all its stock at $15 per share. The oil company then purchased the oil properties of the Southern Pacific Company at a price which was far below the fair market value of the prop-

erties. The Southern Pacific Company then issued to its stockholders rights to purchase at $15 per share one share of the oil company stock for each share of Southern Pacific Company stock owned by them, and such rights were immediately dealt in upon the New York Stock Exchange.

The Metcalf Estate at the time the rights were issued owned 1,000 shares of Southern Pacific stock and accordingly received 1,000 rights, which it sold for $18,000 and after deducting expenses of the sale it received the net sum of $17,805. Before the Board, the Estate contended that the rights should be taxed in accordance with the principle laid down in *Miles* v. *Safe Deposit Co., supra.* In rejecting this contention, the Board said (13 B. T. A. 236, 237):

> In 1921 the Southern Pacific Co. was the owner of all the capital stock of the Pacific Oil Co. In that year it paid a dividend in the form of a right to purchase stock of the Pacific Oil Co. at the price of $15 per share, which right had a fair market value on the date of its receipt of $18 per share. The value of the rights received by the petitioner should have been returned as an ordinary dividend taxable only at surtax rates. *Peabody* v. *Eisner,* 247 U. S. 347. The subsequent sale or other disposition of the property received by way of a dividend would give rise to gain or loss, dependent upon the amount received therefor. In this case petitioner is entitled to deduction of the difference between $18,000

> and $17,805. The tax for 1921 should accordingly be recomputed by including the $18,000 dividends in income as subject to surtax only, and by the allowance of the deduction of $195.

It will be observed that the Board definitely rejected the theory which it adopted in the instant case. The Board held that the receipt of the rights constituted property dividends of a value of $18,000, subject to surtax only, and that upon the sale thereof the net realization of $17,805 resulted in a deductible loss (for both normal and surtax purposes) of $195.

Upon appeal, the Estate's brief was all written under a single point headed, "The issuance of the rights was not a dividend", and the Commissioner briefed it under the heading, "Rights accruing to a stockholder in a corporation to purchase stock in another corporation at less than the actual value of the stock are equivalent to dividends and taxable as income." Thus the question presented to the court was whether the issuance of the rights constituted a taxable dividend, and the court stated that it did, saying (p. 194):

> Thus, where a stockholder receives a distribution of the assets of a corporation in cash or in stock of a different enterprise, such distribution is for taxing purposes a dividend. *No sound distinction can be drawn between a distribution of stock of another corporation and one of valuable*

> *rights to purchase such stock.* Each may be sold at its selling price. The rights this petitioner sold netted $18 per right. They amounted to a distribution of assets of the company of which it was a stockholder, just as much as an actual distribution of stock of the Baltimore & Ohio Railroad by the Union Pacific Company did in the Peabody Case. *There was a distribution in specie of a portion of the assets of the Southern Pacific Company.* A distribution of earnings or assets of a corporation is a distribution, whether or not so determined. [Italics supplied.]

The only difference between the *Metcalf* case and the instant one is that in the former the rights were sold, whereas here they were exercised. But it seems clear in the above quotation that the decision would have been the same had the rights been sold or exercised.[4]

As shown above, the Board of Tax Appeals has not been consistent in its decisions on the subject. In *Duke* v. *Commissioner*, 18 B. T. A. 374, the

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[4] The court in the *Metcalf* case states in one part of its opinion (p. 193) that "The question presented is whether, by the selling of these rights, the petitioner received taxable income * * *." This was natural in view of the fact that the fair market value of the rights upon receipt by the estate was the same as the price received by the estate upon sale of the rights. But it is clear from the court's opinion as a whole that the court agreed with the Board that the receipt of the rights, apart from their sale, constituted a dividend amounting to the fair market value of the rights upon receipt by the estate.

stockholders of the American Tobacco Company were in 1912 given the right to subscribe, share for share, to stock of the P. Lorillard Company at $100 per share. The taxpayer, as the owner of 378 shares of American Company stock, exercised the rights, paid the sum of $37,800, and received 378 shares of Lorillard stock. The rights at the time of their receipt by the taxpayer had a market value of $80 per right. In 1920, the taxpayer sold the Lorillard stock at $127 per share and claimed a loss based upon a cost basis of $180 per share ($100 plus $80, the value of the right when received in 1912). The Commissioner disallowed the loss and computed a profit based upon a cost of $100 per share. Upon appeal to the Board of Tax Appeals, the taxpayer's contention was sustained, the Board saying (p. 376):

> *The right to purchase stock in the newly organized P. Lorillard Co. granted to shareholders in the American Tobacco Co. was in the nature of a dividend which, had it occurred in a taxable year, would have been taxable. Edwin P. Metcalf,* 13 B. T. A. 236. That these rights were valuable appears from the quoted market price of $80. Looking at the transaction broadly, the consideration paid for the stock was $100 cash plus the surrender or exercise of a right. By such surrender of one of these rights and the payment of $100 petitioner acquired property (a share of stock) worth $180 on the market. The purchase of a share of stock

> by one not possessing a right could have been accomplished only by paying $180 on the open market. Therefore, when petitioner exercised the right previously issued her, she merely converted property worth $80 into another form. It follows that the cost to petitioner of the stock in P. Lorillard Co. was $100 in cash plus the surrender of a right worth $80, or a total cost of $180. [Italics supplied.]

In line with the principle enunciated in the *Metcalf* and *Duke* cases is *Morris Run Coal Mining Co.* v. *Phillips,* 7 F. Supp. 730, 732 (M. D. Pa.), where rights issued by the Lehigh Valley *Railroad* Company to purchase stock in the Lehigh Valley *Coal* Company were held to be dividend distributions.

The same question involving the same rights as are under consideration here was passed upon by the Second Circuit in *Ramapo, Inc.* v. *Commissioner,* 84 F. (2d) 986, and by the Seventh Circuit in *Commissioner* v. *Mayer,* 86 F. (2d) 593, now pending on writ of certiorari under the title, *Mayer* v. *Helvering,* No. 22, present term. In both cases the court was of the opinion that the taxpayers had received taxable dividends. In the *Ramapo* case the court said (pp. 987–988):

> But, if the rights are to purchase stock in another corporation at less than its fair market value, the issuance of them is a distribution of corporate assets in the amount by which the value of the stock exceeds the

> price to be paid for it, and, if such excess represents earnings or surplus, is a dividend. This would appear to be self-evident. * * * Of course, if full value is paid for the stock no dividend is received by the shareholder. The controlling issue, therefore, in passing upon the correctness of the Board's decision, is whether the shareholders of Superpower were given rights to purchase the stock of the United Corporation and the Commonwealth & Southern Corporation at less than its fair market value; for, if they were, to the extent that the value of the stock exceeded the price payable, they received a distribution of property which was a dividend, * * *. Such distribution was therefore a dividend.
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> * * * * *

The taxpayer cites and relies principally upon *Helvering* v. *Bartlett*, 71 F. (2d) 598 (C. C. A. 4th); *Commissioner* v. *Cummings*, 77 F. (2d) 670 (C. C. A. 5th); *Taplin* v. *Commissioner*, 41 F. (2d) 454 (C. C. A. 6th); and *Commissioner* v. *Van Vorst*, 59 F. (2d) 677 (C. C. A. 9th). But such cases are readily distinguishable from the instant one. The *Bartlett* case turned entirely on a question of fact as to whether the corporation distributed the rights to its stockholders or whether it acquired them as their agent. The facts were succinctly set forth in the opinion of the Board of Tax Appeals (28 B. T. A. 285), as follows (p. 288):

> The facts of the instant case are different from those of the cases cited by the respond-

> ent [*Peabody, Phellis, Rockefeller* and *Metcalf* cases]. Here the Guaranty Co. *acted as agent* for the Fire Co. in distributing 25,000 shares of the latter's stock to stockholders of the former. It subscribed for 25,000 shares on its own account and for 25,000 which were to be taken by its stockholders at the subscription price. *It never received certificates for the latter 25,000 shares and it never owned them.* Payment was made therefor only after the money had been collected from the subscribers. Surplus of the Guaranty Co. was in no way affected by the transaction and it received no benefit from the subscription price, which was immediately paid over to the Fire Co. [Italics supplied.]

The distinction between that case and the case at bar is obvious. The Guaranty Company never owned the stock of the Fire Company, which was distributed, as did Superpower in the instant case. As stated in the opinion of the Circuit Court of Appeals (p. 600):

> All that the *Guaranty* Company did was to acquire *in behalf of its stockholders* options to subscribe to stock in the Fire Company and to allot these options to them in accordance with their holdings; * * * [Italics supplied.]

The Guaranty Company, acting as agent for its stockholders, collected the subscription price and turned it over to the Fire Company, and the Fire

Company issued its stock directly to the subscribing stockholders. The Guaranty Company was never anything more than an intermediary in obtaining from its stockholders subscriptions to the stock. The transaction did not result in the distribution of any assets belonging to the Guaranty Company for the very good reason that the latter company never owned the distributed stock, as did Superpower in the present case.

In the *Cummings* case, *supra,* the taxpayer did not acquire rights as a stockholder but purchased in 1925 option warrants entitling him to acquire at a certain price stock of the Southeastern Power & Light Company. In June, 1929, he exercised the warrants and thus acquired a certain number of shares of stock, a portion of which he later in the same year sold at a profit. The sole question presented was whether any portion of the profit was taxable as a capital net gain—that is, whether any portion of the stock had been held for over two years as required by the statute. The court held that the holding period of the warrants should be tacked to the holding period of the stock, and thus permitted a portion of the profit to be taxed at capital net gain rates. The facts of the case have nothing in common with those in the instant case and the question presented was not related to that presented here. It is evident that the case does not support the taxpayer's contention.

In the *Taplin* case, *supra,* a corporation transferred to three of its stockholders who owned approximately 68 per cent of its stock, shares of stock in another corporation, of the value of $30 per share, for a price of $7 per share. In the *Van Vorst* case, *supra,* a corporation sold to its principal stockholder, who owned approximately 93 per cent of its outstanding capital stock, real estate of the fair market value of $154,000 for a consideration of $54,000. In both cases the courts held that the difference between the purchase price and the fair market value did not represent a taxable dividend. It will be observed that in neither of these cases was there a distribution by the corporation to the stockholders, because they were stockholders and in proportion to their respective holdings. In both cases there was a mere sale to a particular stockholder or group of stockholders, with no equivalent rights distributed or offered to the remaining stockholders, and the tax liability claimed by the Commissioner was predicated entirely on the inadequacy of the sales price. In each case there were valid reasons for effecting a sale, a *bona fide* intent to enter into an ordinary sale transaction, and no evidence whatever of any intent to effect a *pro rata* distribution of assets among stockholders. Neither decision is in any manner contrary to the decisions in the *Metcalf* and *Duke* cases, *supra,* and neither has any application to the facts in the instant case.

We submit that the instant case is clearly distinguishable from the cases relied upon by the taxpayer. Here, the directors of Superpower, the proper authority to declare dividends, dealt with the stockholders as a class, not as individuals, and distributed *pro rata* among such stockholders valuable rights which each stockholder could sell on the market or exercise, as he might choose. The transaction was carried out in such a manner that it cannot possibly be denominated a mere sale by Superpower and a purchase by the stockholders. The rule that taxable income does not ordinarily flow to a taxpayer by reason of a purchase has no application to the facts in the instant case, for here, by proper corporate action, the stockholders of Superpower received, as a fruit of their stock ownership, valuable property rights pertaining to a portion of the assets of the corporation.

II

THE STIPULATED FACTS WHICH WERE ADOPTED BY THE BOARD AS ITS FINDINGS CONCLUSIVELY SHOW THAT THE SUBSCRIPTION PRICES UNDER THE RIGHTS WERE MATERIALLY LESS THAN THE MARKET VALUE OF THE STOCK

The taxpayer contends that the Board made a finding of fact that the fair market value of United stock in January, 1929, was $25 per share and that the court below disregarded that finding. The Board in its opinion said (R. 164).:

> No valid argument can be made that Superpower intended to distribute to its stock-

> holders any portion of its assets by selling 821,472 common shares of United to them at a fair market value. Upon the sale of the stock at $25 per share Superpower realized a profit of $16.05 on each share. That $25 was a fair market price for the stock in January 1929 is further evidenced by the fact that J. P. Morgan & Co. and Bonbright & Co., pursuant to the agreement made between the interested parties, each subscribed for and purchased from United 400,000 shares of its common stock at $22.50 per share.

Taxpayer argues that this is a finding of fact and that if it is supported by substantial evidence it must be accepted by the Circuit Court of Appeals. It is our position that the above is not a finding of fact, but is merely an argument used by the Board to support its conclusion that the several transactions did not represent the distribution of taxable dividends. The Board expressly adopted the stipulated facts as its findings. (R. 170.) But if the statement be accorded the dignity of a finding, we submit that it is not supported by any substantial evidence.

The January rights entitled the holders to purchase United common at $25 per share and at the rate of one share of United for each two shares of Superpower. These rights were extensively dealt in on the New York Curb Exchange at prices ranging from 11⅝ to 21 per right, or from $23 to $42 for the two rights required to obtain one share.

(R. 67.) Between January 29 and January 31, 1929, Superpower sold on the market 9,279 shares of United stock at prices ranging from $56.96 to $63.46 per share. (R. 84.) The rights were mailed by Superpower to its stockholders on January 31, 1929, and were received by the taxpayer on February 1, 1929. (R. 66.) On the latter date the rights sold on the Curb market at prices ranging from 16¼ to 18 per right, or from $32.50 to $36 for the two rights required to obtain one share. Add to these prices the $25 which was payable to Superpower for the stock, and the total indicates that the fair market value of the United stock on February 1, 1929, the date taxpayer received his rights, was from $57.50 to $61 per share. These values compare favorably with the prices at which the stock was sold to the public by Superpower on January 29, 30, and 31, 1929.

The Board's finding, if such it were, of a $25 fair market value for United stock in January was based upon two considerations which in no way contradict the findings as to fair market value of United stock just set forth in the preceding paragraph. First the Board referred to the determination of the Commissioner in another proceeding in the Bureau that the value of the United securities received by Superpower in exchange for the securities delivered to United was $72,480,000, and that $55,271,325 of that amount should be allocated to the 2,210,853 shares of United common (R. 85):

Secondly, the Board referred to the fact that J. P. Morgan & Co. and Bonbright & Co., subscribed for common stock in United at $22.50 per share. Both of these considerations relate to the time of formation of United which was several weeks before the critical dates here in question. (R. 73–76, 84–85.) The determination of the Commissioner referred to by the Board cannot control in the face of the Commissioner's determination in this proceeding of a deficiency based upon a fair market value of United stock greatly in excess of $25 per share. This determination is presumed to be correct (*Welch* v. *Helvering,* 290 U. S. 111) and is fully supported by non-conflicting evidence of market prices at the critical dates. The subscription prices for United common paid by Morgan and Bonbright, have no relevance to the question of fair market value, since those prices were obtained in private sales between United and its organizers at the time of formation of United. Finally, it should be noticed, in any event, that the two facts referred to by the Board could have little if any relevance to the second distribution of rights to United stock which occurred in May, and no relevance whatever to the distribution of rights to Commonwealth stock.

Concerning the May and June rights, the Board, in its opinion, said (R. 164):

> The stipulated facts do not show the fair market value of United common stock in

May 1929, or of Commonwealth common stock in June and July 1929.

But the record does show that the fair market value of the United and Commonwealth stock in May and June, 1929, was materially greater than the prices at which the two stocks could be obtained under the rights.

The May rights entitled the holders to purchase United common at $30 per share and at the rate of one share of United for each four shares of Superpower. These rights were sold on the New York Curb Exchange, during the option period, at prices ranging from 6⅛ to 11⅜ per right (R. 69–70), or roughly from $25 to $45 for the four rights necessary to acquire one share. Add to these prices the $30 which was payable to Superpower for the stock and the total indicates a fair market value of from $55 to $75 per share.

The June rights entitled the holders to purchase Commonwealth stock at $15 per share and at the rate of one share of Commonwealth stock for each ten shares of Superpower. These rights were sold on the market, during the option period, at prices ranging from 1 1/16 to 1 15/16 per right (R. 72), or, roughly, at from $7.50 to $19 for the ten rights necessary to acquire one share. This would indicate that the fair market value of the Commonwealth stock during the period from June 6 to July 2, 1929, was from $22.50 to $34 per share.

These facts, although incorporated in the Board's findings, were ignored or overlooked by

the Board in its opinion. The prices at which the several series of rights sold on the Curb Exchange obviously represent approximately the difference between the market value of the stocks to which the rights pertained and the subscription prices at which the stock could be obtained by exercising the rights. This may be illustrated by comparing the market prices of United rights on January 29th, 30th and 31st (R. 67) with Superpower's sales of United stock on those same dates (R. 84). The mere fact that the rights were valuable and had an active market conclusively shows that the fair market value of the stock was substantially higher than the price at which it could be obtained under the rights. Otherwise, it would be impossible to account for any market value for the rights themselves.

The Second Circuit, in *Ramapo, Inc.* v. *Commissioner, supra,* disposed of this contention as follows (p. 988):

> These stipulated quotations conclusively establish in our opinion that the stock distributed by Superpower had a fair market value largely in excess of the prices at which it was "sold" to the shareholders. The respondent asserts, however, that the Board made a contrary finding with respect to United stock subject to the January rights, and that this finding is supported by substantial evidence. The finding in question appears as a statement in the opinion in *Pal-*

mer v. *Commissioner,* 32 B. T. A. 550, which was tried and decided with the case at bar. The evidence relied upon is the fact that early in January, 1929, when The United Corporation was formed, the promoters allotted several million shares among themselves at an agreed price of slightly less than $25 per share. What the promoters agreed upon at that time cannot, in our opinion, justify disregarding actual market quotations of numerous transactions at the critical date several weeks later. A finding that the rights had no value cannot be sustained in the face of the additional findings as to market quotations of rights and stock.

* * *

III

THE AMOUNT OF THE DIVIDEND SHOULD BE DETERMINED BY VALUING THE STOCK OR RIGHTS AS OF THE DATE THE RIGHTS WERE RECEIVED BY THE TAXPAYER

The Commissioner of Internal Revenue, in asserting the deficiency, determined the amount of the dividend by valuing the rights as of the dates named in the corporate resolutions for determining the stockholders of record entitled to receive the rights, *viz.,* January 26, May 8, and June 16, 1929. Before the Board of Tax Appeals, the Commissioner asked that the deficiency be increased should the Board find that in determining the amount of the dividend the rights should be valued as of some other date. The Board of Tax Appeals held that

the taxpayer was not in receipt of taxable dividends as a result of the above mentioned transactions and therefore found it unnecessary to pass upon the question.

In petitioning for review before the Circuit Court of Appeals, the Commissioner assigned as error, *inter alia,* the failure of the Board to hold that taxable dividends had been received equal to the market value of the rights when receivable by the taxpayer (R. 183, par. 7), or when received by the taxpayer (R. 183, par. 8, 9). The Circuit Court of Appeals reversed the Board, holding that taxable dividends had been received, but that their amount should be determined by valuing the stock as of the dates the rights were exercised. (R. 192.)

It is our position that the amount of the dividend should be determined by valuing the rights as of the dates they were received by the taxpayer. This is in accordance with the rule laid down in *Avery* v. *Commissioner,* 292 U. S. 210, and *Ramapo, Inc.* v. *Commissioner, supra.* In the *Avery* case the United States Gypsum Company in November declared a dividend payable on or before the 31st day of December following. It was shown that the regular policy of the company was to declare dividends quarterly, in each instance payable on or before the last day of the month, so as to reach the stockholders on the following day. This Court stated that the only question presented for determination was when, within the intendment of the

statutes, the dividends were "received" by the taxpayer. The Commissioner claimed that the dividends constituted income for the years in which they were declared and made payable. The taxpayer claimed that they were taxable for the year in which he received the check. This Court said (p. 215):

> In the disclosed circumstances the dividends cannot properly be considered as cash or other property unqualifiedly subject to the petitioner's demand on December 31st. It was the practice of the Company to pay all dividends by checks not intended to reach stockholders until the first business day of January; there is nothing to show that petitioner could have obtained payment on December 31st, he did not expect this and the practice shows the company had no intention to make actual payment on that day. Nothing indicates that it recognized an unrestricted right of stockholders to demand payment except through checks sent out in the usual way. The checks did not constitute payments prior to their actual receipt. The mere promise or obligation of the corporation to pay on a given date was not enough to subject to petitioner's unqualified demand "cash or other property"; and none of the parties understood that it was.

The rule laid down in that case is directly applicable to the situation here in question. The several resolutions adopted by Superpower provided no means by which a stockholder could

exercise its right to acquire United and Commonwealth stock, except upon surrender of the purchase certificates, and in each case the officers of the company were directed to mail the certificates to the stockholders. In the letter advising the stockholders of the action taken, in connection, for example, with the January rights, the company stated (R. 13), "Purchase Certificates evidencing the above purchase privilege will be mailed to stockholders * * * on or about February 1, 1929", and the necessary deposit of United stock for the purpose of carrying out the purchase options was not made until January 30, 1929 (R. 66). No provision was made whereby the stockholders could have exercised their rights and acquired the United and Commonwealth stock prior to receipt of the rights through the mail nor in any other manner than by surrendering the certificates so received by them together with the sums of money necessary to obtain the stock. Prior to that time, of course, they had an interest in the stock owned by Superpower, the rights in which were subject to distribution under the resolutions adopted, but that interest was identical with the interest of any stockholder in a cash dividend which has been duly declared but not yet paid.

Whether the dividend be regarded as the stock in question, the intangible right to acquire such stock or the purchase certificate evidencing the right, there was receipt, or at least constructive receipt, of the dividend upon receipt of the purchase

certificate, since at that time the rights or shares of stock involved became unqualifiedly subject to the stockholder's demand. Whether he thereupon immediately tendered the purchase certificate, together with the requisite amount of cash, and obtained his certificate of stock or postponed such action until some later date prior to the expiration of the right was entirely within his control.

In the *Ramapo* case, which involved the same rights as are under consideration here, the Second Circuit held that the amount of the dividend should be determined as of the date the respective rights were received. The court said in part (p. 988):

> The remaining question relates to the date as of which the rights shall be valued. Cash dividends are not income to a shareholder until absolutely at his disposal. *Avery* v. *Commissioner*, 292 U. S. 210, 54 S. Ct. 674, 78 L. Ed. 1216. No reason is apparent for distinguishing between cash and property dividends as to the time when they become income. The date when the respective rights became available to the shareholders was when the certificates or warrants were received, and that is the date as of which they should be valued. * * *

We submit on the authority of the *Avery* and *Ramapo* cases that the dividend was unqualifiedly subject to the taxpayer's demands on the date the several issues of rights were received by him. Accordingly, the amount of the dividend should be determined as of those dates.

CONCLUSION

It follows that the decision of the Circuit Court of Appeals, holding that the taxpayer was in receipt of a taxable dividend as a result of the transactions in question, should be affirmed, and should be reversed in so far as it held that the amount of the dividend should be determined as of the date the rights were exercised.

Respectfully submitted.

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SUPREME COURT OF THE UNITED STATES.

Nos. 19 and 59.—October Term, 1937.

Bradley W. Palmer, Petitioner, 19 *vs.* Commissioner of Internal Revenue. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, 59 *vs.* Bradley W. Palmer.	On Writs of Certiorari to the United States Circuit Court of Appeals for the First Circuit.

[November 8, 1937.]

Mr. Justice Stone delivered the opinion of the Court.

The question for decision is whether a purported sale by a corporation to its stockholders, of shares of stock issued by and acquired from another corporation, the sale being effected by means of an issue to the stockholders of rights to purchase the stock at a named price, is to be treated as a distribution of corporate earnings taxable as a dividend to the stockholders when received, within the reach of §§ 22 and 115 of the Revenue Act of 1928, c. 852, 45 Stat. 791.

In January, 1929, The American Superpower Company, of which petitioner was a stockholder, acquired through consolidation of public utility corporations, in some of which it in turn was a stockholder, a large amount of the securities of The United Corporation, the latter being received in exchange for stock of the consolidated corporations owned by Superpower. The securities received included shares of the preference stock of United, 2,210,583 shares of its common stock, and 1,000,000 rights to subscribe for United common stock at any time for $27.50 a share. United was incorporated January 7, 1929. The consolidation was effected January 12th, when Superpower became entitled to its allotment of the securities. On January 23, 1929, the board of directors of Superpower, pursuant to a plan to strengthen its cash position and to create a wide market for the stock of United, adopted a resolution offer-

ing to its common stockholders of record January 26, 1929, the privilege of purchasing, at $25 a share, one-half share of United for each share of their common stock in Superpower. The privilege was evidenced by negotiable certificates distributed to stockholders about January 31. By their terms they were to become void unless the privilege was exercised by February 15, 1929. On that date petitioner exercised the privilege by purchasing his allotment of 3,198 shares of United at $25 a share. In its books, records and accounts, Superpower treated the transaction as a sale of the United stock, resulting in no change in its net assets or earnings.

The prices received by Superpower for shares distributed to its stockholders represented a substantial profit to it over cost of the securities which it had exchanged for them. It reported the profit in its 1929 income tax return and paid the tax on it for that year. In computing the tax the commissioner in allocating the cost of the three classes of securities received from United by Superpower, found it necessary to determine the value of each class of security when received. He did this by finding the total value of the securities and allocating to the common stock a value of $25 a share. On or about January 9th, bankers who were active in promoting the consolidation purchased from United 400,000 shares of its stock at $22.50 per share. Shortly after the adoption by Superpower, on January 23rd, of the plan for distribution of the United stock, an active market developed on the New York Curb Exchange for the sale of subscription rights. On January 25th, 11,000 rights were sold at prices ranging from 11⅝ to 12⅜, making the cost per share to purchasers of the rights, upon their exercise, about $50. On January 28th, 44,000 of them were dealt in on the exchange at prices ranging from 12⅝ to 17½, with a corresponding cost of the shares of from $50 to $60. On January 29th, 30th and 31st, Superpower sold about 9,200 shares of its United stock on the open market at from $50 to $63 per share.

On May 1, 1929, a like privilege to purchase one-fourth of a share of stock of United at $30 a share for each share of Superpower was extended to the stockholders of the latter, as of May 8, 1929, which petitioner similarly exercised on May 24, 1929. On June 5, 1929, a like privilege was given to the common stockholders of Superpower as of June 18, 1929, to purchase stock of Common-

wealth and Southern Corporation at $15 a share, which petitioner exercised on July 2, 1929.

Petitioner did not, in 1929, sell or otherwise dispose of any of the shares for which he subscribed, or report their receipt in his income tax returns for that year. The commissioner ruled that the rights to subscribe were dividends and assessed a deficiency against petitioner based on their market value on the respective dates when the stockholders were first entitled to exercise them. The cause was heard by the Board of Tax Appeals upon a stipulation of facts which it adopted as a finding and which specified the facts already detailed. The board held that the distributions were sales of the shares by Superpower to its stockholders, not dividends, and reduced the deficiency accordingly. In reaching this decision the board, upon consideration of all the facts and circumstances attending the issue of the rights by Superpower to its stockholders, found that there was no intention to distribute any of its earnings to stockholders and that the transaction was what it purported to be on its face—a sale to stockholders of part of the corporate assets. As a supporting fact it found that the fair value of the common stock of United during January, 1929, was $25 a share. It concluded that the facts as stipulated and as found by it did not show fair market value of the United stock in May, 1929, or of the Commonwealth and Southern stock in June or July of that year. Upon the entire record it was of the opinion that there was no reason to treat the transaction any differently than the parties had treated it, as a sale of a part of the assets of Superpower from which no taxable gain would result before the taxpayer sold or otherwise disposed of the shares.

The Court of Appeals for the First Circuit reversed, holding that the distributions were taxable dividends measured by the difference between the value of the several allotments of shares on the respective dates when the rights were exercised and the prices paid for them. 88 F. (2d) 559. In reaching this conclusion the court recognized that the board had found the January, 1929, value of the stock of United to be $25 a share. But it thought that the board in making the finding had disregarded the substantial prices at which the rights were sold pending their exercise, denying to them persuasive weight because it had mistakenly assumed that the

purported sale could not be treated as a dividend unless there was intention to distribute the corporate earnings. The court held that what was done, and not what was intended, was the decisive factor and as there was substantial evidence that the stock, when distributed, was worth more than the price received, there was a distribution of corporate assets from earnings, taxable to stockholders as a dividend. It accordingly remanded the cause to enable the board to ascertain the value of the distributed shares on the dates when the rights were exercised (February 15, 1929, May 24, 1929, July 2, 1929).

Both the taxpayer and the commissioner petitioned for certiorari, the one challenging the ruling that the distributions were dividends, and the other assigning as error the failure to hold that the critical dates for fixing the value of the dividends for taxation were either those when the rights were received by the stockholders or when the stockholders first became entitled to exercise them, rather than the times when they were actually exercised. We granted certiorari, 301 U. S. —, because of the importance of the questions in the administration of the revenue laws, and the doubts which have been raised as to their appropriate answers by the varying opinions of the circuit courts of appeals. Compare the opinions below, *Ramapo, Inc.* v. *Commissioner,* 84 F. (2d) 986 (C. C. A. 2d) and *Commissioner* v. *Mayer,* 86 F. (2d) 593 (C. C. A. 7th) with *Helvering* v. *Bartlett,* 71 F. (2d) 598 (C. C. A. 4th) and *Commissioner* v. *Cummings,* 77 F. (2d) 670 (C. C. A. 5th).

By §§ 111, 112 and 113 of the Revenue Act of 1928, profits derived from the purchase of property, as distinguished from exchanges of property, are ascertained and taxed as of the date of its sale or other disposition by the purchaser. Profit, if any, accrues to him only upon sale or disposition, and the taxable income is the difference between the amount thus realized and its cost, less allowed deductions. It follows that one does not subject himself to income tax by the mere purchase of property, even if at less than its true value, and that taxable gain does not accrue to him before he sells or otherwise disposes of it. Specific provisions establishing this basis for the taxation of gains derived from purchased property were included in the 1916 and each subsequent revenue act and accompanying regulations.

Section 22 of the Revenue Act of 1928 includes "dividends" in "gross income", which is the basis of determining taxable net income and § 115 defines "dividend" as "any distribution made by a corporation to its ~~stockholders~~ shareholders, whether in money or in other property, out of its earnings or profits." While a sale of corporate assets to stockholders is, in a literal sense, a distribution of its property, such a transaction does not necessarily fall within the statutory definition of a dividend. For a sale to stockholders may not result in any diminution of its net worth and in that case cannot result in any distribution of its profits.

On the other hand such a sale, if for substantially less than the value of the property sold, may be as effective a means of distributing profits among stockholders as the formal declaration of a dividend. The necessary consequence of the corporate action may be in substance the kind of a distribution to stockholders which it is the purpose of § 115 to tax as present income to stockholders, and such a transaction may appropriately be deemed in effect the declaration of a dividend, taxable to the extent that the value of the distributed property exceeds the stipulated price. But the bare fact that a transaction, on its face a sale, has resulted in a distribution of some of the corporate assets to stockholders, gives rise to no inference that the distribution is a dividend within the meaning of § 115. To transfer it from the one category to the other, it is at least necessary to make some showing that the transaction is in purpose or effect used as an implement for the distribution of corporate earnings to stockholders.

The facts stipulated and the finding of the fair market value of the United stock at the time of the adoption of the first plan for its distribution abundantly sustain the board's conclusion that the transaction—in form a sale—was not intended to be the means of a distribution of earnings to stockholders. There may be cases in which market quotations, after the subscription rights have been issued, are persuasive evidence of value as of the time when the plan was adopted, and hence of its purpose and probable effect. But we cannot say that the board here, in finding the value of the shares of the newly organized United as of the time of adoption of the first plan, did not consider the market prices of the rights. The findings are inferences which the board was free to draw from all the facts and circumstances disclosed by the record. Such a

determination of fact is not to be set aside by a court even if upon examination of the evidence it might draw a different inference. *Helvering* v. *Rankin*, 295 U. S. 123, 131, 132; *Elmhurst Cemetery Co.* v. *Commissioner*, 300 U. S. 37. We accept the findings as at least establishing that the plan was adopted by Superpower in good faith as a means of effecting a sale of its assets to stockholders at fair market value. Hence the issue for decision, in so far as the first allotment of stock is concerned, is narrowed to the question of law whether the commitment of Superpower, by formal action of its board, to the sale of United stock at its then fair market value and the ensuing distribution to stockholders is taken out of the category of sales and placed in that of dividends by the fact that, pending execution of the project, rights to subscribe sold on the exchange at substantial prices, or that the stock itself sold at prices substantially above the stipulated purchase price.

First. The mere issue of rights to subscribe and their receipt by stockholders, is not a dividend. No distribution of corporate assets or diminution of the net worth of the corporation results in any practical sense. Even though the rights have a market or exchange value, they are not dividends within the statutory definition. Cf. *Miles* v. *Safe Deposit & Trust Co.*, 259 U. S. 247; *Helvering* v. *San Joaquin Co.*, 297 U. S. 496; *Helvering* v. *Bartlett*, *supra*. They are at most options or continuing offers, potential sources of income to the stockholders through sale or the exercise of the rights. Taxable income might result from their sale, but distribution of the corporate property could take place only on their exercise. The question, then, is whether the distribution which results from the exercise of the rights must be regarded as a dividend if the reasonable value of the property at the time of exercise is more than the purchase price.

Second. We think that a distribution of assets by a corporation to its stockholders by means of a sale, to which it is committed by appropriate corporate action at a time when their sale price represents their reasonable value, is not converted into a dividend by the mere circumstance that later, at the time of their delivery to stockholders, they have a higher value. The meaning of § 115 must be sought in the light of the situations to which it must be applied. It does not purport to withdraw corporations and their stockholders wholly from the operation of §§ 111, 112 and 113, taxing the profits of purchasers. It cannot be taken to withhold from corporations

the power at their own election to effect, by workable means, sales of their assets to stockholders at fair value, subject to that incidence of taxing statutes which usually attends sales. The distribution contemplated and defined by it as a dividend is one to be effected by corporate action. Hence, in determining whether a given transaction is "sale" or "dividend", the corporate action which results in one or the other must be scrutinized in the light of the circumstances at the time when the action is taken, and of the conditions under which in practice it must be taken.

The only feasible method by which a corporation of large membership can effect a sale of its assets to stockholders is by tendering to them rights to subscribe, a method whose indispensable first step is the adoption, by appropriate corporate action, of the terms of the offer. Between the dates of the first step and of subscription a substantial period of time must elapse, during which the rights may, and often do, become the subject of violent market fluctuations. Any vendor who offers property for sale at a named price similarly carries the burden of risk that the property may increase in value between offer and acceptance. If the sale is by executory contract he also carries the risk between promise and performance. It is an inseparable incident of every sale except those in which conditions admit of payment for the property simultaneously with its tender for sale, a procedure which may not be available to a corporation seeking to sell its property to stockholders.

It is a solecism to speak of a corporation as distributing its profits for the sole reason that, after it has unavoidably assumed that risk in order to effect a sale of its property to stockholders at a fair price, the property increases in value. Price, which in the present case is decisive of the issue, must be determined in the light of the situation existing when price is fixed. If the option price is fair when fixed the transaction is a tender for a sale and not for a distribution of profits—a dividend as defined by § 115. If, pending execution of the plan, there were no change in value of the stock the transaction would throughout concededly retain its character as a sale. Its character is not altered by the fluctuations of a speculative market, after the corporate action which defines the character of the transaction has been taken.

When the corporation has committed itself to a sale of its assets to stockholders at present market value the effect on its bal-

ance sheet is the same as in the case of other vendors who in various ways assume the risk of rising prices pending the consummation of the sale. In every case purchasers may, as a result of market change, acquire property at less than its value at the date of acquisition. But in the case of the corporation it does not follow that there has been a distribution of its profits. It can hardly be said that profits accrue to a corporation from a fortuitous gain in market value, the benefits of which it has relinquished before the gain occurs. Distribution of profits is neither the purpose nor effect of the action taken by the corporation and there is no adequate basis for saying that the transaction to which the directors committed their corporation was the distribution of earnings, and hence a dividend rather than a fairly conducted sale of corporate property with all the incidents which usually attend a sale when the price is fixed in advance of performance. It is decisive of the present case, so far as the first allotment of United shares is concerned, that distribution of corporate assets, effected by the sale, was not intended to be a means of distributing earnings, and that the price when fixed represented the fair market value of the property to be distributed.

There has been no finding, either by the commissioner or the board, of the fair market value of the United stock in May or of the Commonwealth & Southern in June, the months when the plans for the second and third allotments of the shares were adopted. The finding of the board that the facts as stipulated were not sufficient to establish fair market value of the shares on those dates furnish sufficient support for its conclusion that there was no basis for treating the transactions, which were on their face sales, as distributions of earnings and hence dividends as defined by § 115.

The writ in No. 59 is dismissed and in No. 19 the judgment is

Reversed.